

SUBCOMMITTEE NO. 1 on Education



Subcommittee No. 1
Chair, Jack Scott
Member, Bob Margett
Member, Joe Simitian

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OUTCOMES

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ITEM 6110 DEPARTMENT OF EDUCATION

ISSUE 1: Proposition 98 – Overall Funding in 2004-05 & 2005-06

DESCRIPTION: The Governor proposes to maintain Proposition 98 funding for K-14 education (K-12 schools and community colleges) at \$47.1 billion, roughly the level appropriated by the 2004-05 Budget Act.¹ The Governor proposes \$50.0 billion for K-14 education in 2005-06, an increase of \$2.9 billion (6.1 percent) over 2004-05.

BACKGROUND:

K-14 Proposition 98: 2004-05

The 2004-05 budget appropriated \$47 billion for K-14 education, which was approximately \$2.0 billion below the minimum guarantee at the time of enactment. Chapter 213, Statutes of 2004 (SB 1101/Committee on Budget and Fiscal Review) suspends the minimum funding provisions of Proposition 98 in 2004-05.

The Governor's budget assumes that state revenues will grow by \$2.2 billion beyond the level originally budgeted in 2004-05. Due to the larger than estimated state revenues and student enrollments, the minimum guarantee has grown an additional \$1.1 billion since then. The Governor does not propose to fund this overall increase, estimated to save \$2.3 billion over two years.

The LAO estimates that state revenues will grow by an additional \$1.4 billion in 2004-05 beyond the level assumed in the Governor's budget. According to the LAO's estimates, this would increase the minimum guarantee an additional \$1.9 billion above the budgeted level in 2004-05.

K-14 Proposition 98: 2005-06

The Governor proposes \$50.0 billion for K-14 education in 2005-06, an increase of \$2.9 billion (6.1 percent) over 2004-05. (See table on next page.) As proposed, the Governor indicates that the budget meets the Proposition 98 minimum funding guarantee in 2005-06. The Governor calculates the minimum guarantee for the 2005-06 budget using *Test 2* factors applied to the 2004-05 base, as currently budgeted. The Governor's Budget does not propose suspension of Proposition 98 in 2005-06.

1/ The Governor's budget accounts for an increase of \$122.6 million in General Fund revenue limit apportionments to reflect a number of different factors in 2004-05. Specifically, the budget provides \$114.3 million for higher than estimated student enrollments and \$29.5 million to compensate for a loss in estimated property tax revenues. In addition, the budget recognizes \$24.5 million in savings from a reduction in unemployment insurance costs.

K-14 Proposition 98					
Summary	2003-04	2004-05	2005-06		
(dollars in thousands)			Proposed	\$ Change	% Change
<i>Distribution of Prop 98 Funds</i>					
K-12 Education	\$41,800,043	\$42,178,345	\$44,705,043	2,526,698	6.0
Community Colleges	4,370,516	4,803,936	5,162,922	358,986	7.5
State Special Schools	40,302	41,504	41,708	204	.5
Dept. of Youth Authority	36,781	35,859	34,510	-1,349	-3.8
Dept. of Developmental Services	10,863	10,672	10,349	-323	-3.0
Dept. of Mental Health	13,400	8,400	8,400	0	-
Am. Indian Education Centers	3,778	4,476	4,688	212	4.7
Total	\$46,275,683	\$47,083,192	\$49,967,620	\$2,884,428	6.1
<i>Prop 98 Fund Source</i>					
State General Fund	\$30,521,723	\$34,123,805	\$36,532,334	2,408,529	7.1
Local Property Taxes	\$15,753,960	\$12,959,387	\$13,435,286	475,899	3.7
Total	\$46,275,683	\$47,083,192	\$49,967,620	\$2,884,428	6.1
K-12 Enrollment-ADA*	5,958,000	6,015,984	6,063,491	47,507	.8
K-12 Funding per ADA*	\$7,017	\$7,012	\$7,374	\$362	5.2
* Average Daily Attendance					

K-12 Proposition 98: 2005-06

The Governor proposes a total of \$44.7 billion in Proposition 98 funding for K-12 schools in 2005-06, an increase of \$2.5 billion (6.0 percent) above the 2004-05 budget. As proposed, the budget provides \$7,374 per-pupil in Proposition 98 funding in 2005-06, an increase of \$362 (5.2 percent) per-pupil above the 2004-05 budget.

If these figures are adjusted to compensate for \$469 million in additional costs to LEAs under the Governor's CalSTRS proposal, Proposition 98 funding for K-12 education would increase by 5.0 percent, rather than 6.0 percent between 2004-05 and 2005-06. Similarly, per pupil funding would increase by 4.1 percent, instead of 5.2 percent.

Proposition 98 --Community Colleges: 2005-06

The Subcommittee will review Proposition 98 funding for community colleges at the April 11th hearing.

COMMENTS: The LAO will provide testimony and handouts explaining overall Proposition 98 levels in 2004-05 and 2005-06.

The LAO emphasizes that the level of funding that is ultimately approved for 2004-05 is the central issue facing the Legislature. If the Legislature were to fund additional increases in the Proposition 98 guarantee beyond the level budgeted, it would require the state to appropriate between \$2.3 billion and \$4.0 billion in additional General Fund revenues over the two year period.

As currently proposed, the Governor's proposed 2005-06 budget proposes a \$2.9 billion increase for K-14 education. For K-12 schools, this translates into an increase of \$2.5 billion. As indicated below, the Governor proposes to expend additional funds primarily for enrollment growth and cost of living adjustments (COLAs), as well as deficit factor reduction. This will provide nearly \$2.4 billion in general purpose funding for K-12 education in 2005-06. The Governor's proposal to shift \$469 million in state CalSTRS contribution costs to LEAs would count against this increase.

<i>Dollars in Millions</i>	Revenue Limits	Categorical Programs	Totals
Cost of Living Adjustments	\$1,222.1	\$427.6	\$1,649.7
Enrollment Growth	234.7	160.0	394.7
Deficit Factor Reduction	329.3	0	329.3
Restoration of Categorical Programs*		146.5	146.5
Other Program Adjustments			6.5
Totals	\$1,786.1	\$740.6	\$2,526.7

**Several categorical programs were funded with one-time funds available in 2004-05. The budget proposes to restore ongoing funds for these programs.*

OUTCOME: No action.

**ITEM 6300 CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
(CalSTRS)**

ISSUE 2: State Contribution to the Defined Benefit Program

DESCRIPTION: The Governor proposes to shift state responsibility for making contributions to the California State Teachers' Retirement System (CalSTRS) basic retirement program to local employers. Specifically, the Governor's proposal eliminates the state's contribution to the Defined Benefit (DB) program, for an assumed General Fund (Non-98) savings of \$469 million in 2005-06. The proposal increases contributions for CalSTRS employers -- school districts, county offices of education and community colleges -- but does not provide additional funding to cover higher local contributions to the DB program. Additional costs are estimated at \$500 million in 2005-06. The Governor's proposal allows local employers to share costs with CalSTRS employees through collective bargaining.

BACKGROUND: CalSTRS is a state pension program that provides retirement benefits to teachers and other educators employed by K-12 local education agencies (school districts and county offices of education) and community colleges. Currently, CalSTRS provides benefits to approximately 754,000 members and beneficiaries. Unlike public employees covered under the California Public Employees' Retirement System (CalPERS), CalSTRS members do not participate in the social security system.

The Governor's CalSTRS proposal primarily involves changes in the state General Fund contribution to the basic retirement program known as the Defined Benefit (DB) program. The DB program provides a monthly benefit to members when they retire, or become disabled, and also provides benefits to survivors of members who die. Under the DB program the state's contribution equals 2.017 percent of payroll (creditable compensation), which would equate to \$469 million in General Funds (non-98) in 2005-06, absent the Governor's proposal.

The state also contributes 2.5 percent of payroll for purchasing power benefits estimated to total \$581 million General Fund (non-98) in 2005-06. This program is not affected by the Governor's proposal.

Under the DB program, benefits are funded from three sources. Contributions, as a percent of payroll, for each of these sources are fixed in statute as follows:

- Employee Contributions: 8.0 %
- Employer Contributions: 8.25 %
- State Contributions: 2.017 %

Under the Governor's proposal, as contained in trailer bill language, the state DB program contribution of 2.017 percent would be eliminated and school district contributions would increase by 2.0 percent -- from 8.25 to 10.25 percent. As noted in the LAO analysis, the state's contribution of 2.017 percent is pegged to payroll two years ago and would equate to a district payment of 2.0 percent of payroll, or \$500 million, based upon current payroll.

The Governor's proposal also permits school districts to pass through all or some their increased contribution costs to employees through renegotiation of their collective bargaining agreements. If all costs were passed through, the employee contribution could grow from 8 to 10 percent.

In addition, the Governor proposes to give teachers the option of eliminating their 2 percent contribution currently credited to a Defined Benefit Supplement (DBS) program. This option would allow employees to increase their take home pay by reducing contributions from 8 to 6 percent, but also reduce DBS benefits. Under current law, the DBS program ends in 2010. According to the Administration, this proposal is not specifically linked to any subsequent renegotiation of contribution rates for employees.

While not yet reflected in budget trailer bill language, the Administration has signaled that they are also proposing to eliminate a statutory surcharge that is activated when there is unfunded liability to cover 1990-level benefits. This surcharge was triggered for three-quarters of the year in 2004-05 at a rate of 0.524 percent and resulted in a General Fund (non-98) cost of \$92 million. Until new valuation information is available this spring, it is not known if the surcharge will be activated again in 2005-06. The LAO estimates that the full year costs of funding the surcharge is between \$120 and \$170 million in General Funds.

COMMENTS: The CalSTRS Board is opposed to the Governor's DB contribution shift proposal because it (1) potentially worsens the funding condition of the DB program; (2) potentially impairs contractual rights of existing members; and (3) poses a severe administrative burden on local employers and CalSTRS to administer the benefit program.

The LAO does not support the Governor's proposal because it does not achieve the intended savings of \$469 million. The LAO believes that because the proposal shifts costs to LEAs and community colleges it may require rebenching of Proposition 98. If this were the case, the state would have to appropriate \$469 million to LEAs and community colleges.

Taking into account \$469 million in additional costs for LEAs and community colleges under the Governor's proposal, the LAO calculates that the overall Proposition 98 increases falls from 6.1 percent to 5.1 percent from 2004-05 to 2005-06.

The Administration does not believe the proposal would require rebenching as it does not meet the standards for rebenching stated in Education Code Section 41204. The Administration believes that because retirement benefits are viewed as an *existing functional responsibility* of school districts and community colleges, they would not be deemed a *new responsibility* that would require rebenching.

On a much broader level, the LAO believes the Governor's proposal does not fundamentally reform the CalSTRS program to reflect a system that has more local control, responsibility or flexibility. In particular, the LAO is concerned that the state would remain the funder of last resort for any financial shortfalls in the DB program.

The CalSTRS item will be heard by Senate Budget and Fiscal Review Subcommittee #4 on April 20, 2005.

[Trailer Bill Language – See Attachment.]

SUGGESTED QUESTIONS:

- 1. What is the practical effect of this proposal? How will school districts need to respond?*
- 2. Can a school/community college district choose NOT to pay this cost, citing local budgetary constraints?*
- 3. Why does the LAO believe that implementing this proposal would result in a "rebenching" of Proposition 98? (See DOF's position on rebenching above)*

OUTCOMES: No action.

ISSUE 3: Major Adjustments – Enrollment Growth

DESCRIPTION: The Governor’s Budget estimates enrollment growth of 0.79 percent in 2005-06 and proposes \$394.7 million to fully fund enrollment growth for revenue limits and categorical programs subject to statutory growth adjustments.

BACKGROUND: The number of students in K-12 schools, as measured by unduplicated average daily attendance (ADA), is estimated to increase by 47,000 in 2005-06, an increase of 0.79 percent over the revised current-year level. This attendance increase will bring total K-12 (ADA) to 6,063,000 students.

Enrollment growth rates for the last five years are summarized below. Categorical programs receive enrollment growth at budgeted rates, whereas revenue limit enrollment growth is adjusted to reflect actual rates.

Enrollment Growth Rates	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (Proposed)
Budgeted	1.45	1.40	1.37	1.34	.95	.79
Adjusted	1.53	2.06	1.66	.88	.97	

Statewide, year-to-year K-12 enrollment growth rates have been falling since the mid-1990’s when annual enrollment growth was budgeted at more than 2.5 percent. According to the Department of Finance, K-12 enrollment growth is predicted to decline to nearly zero in 2008-09, and after that is expected to start climbing again. The decline in enrollment growth rates reflects the loss of children born to “baby-boomers” who are aging out of the K-12 schools and a steady decline in birth rates during the 1990s.

Enrollment growth patterns play out quite differently for elementary schools and high schools than reflected by statewide trends overall. In particular, elementary schools are experiencing a continued decline in enrollments, while high school enrollments are on the rise statewide.

Enrollment trends also differ greatly among school districts. According to the LAO, 412 school districts (42 percent) are experiencing declining enrollments, as a result of the drop in elementary school enrollments and other factors. The issue of declining enrollment districts will be discussed further at the Subcommittee’s April 4th hearing.

The Governor’s 2005-06 budget proposes \$395 million for enrollment growth assuming a growth rate of 0.79 percent. Of this amount, \$246 million is provided for revenue limits and \$149 million for categorical programs. Additional breakdowns are provided below:

<i>Dollars in Millions</i>	Estimated Growth Rate	Revenue Limit	Special Education	Child Care	Other Categorical Programs	TOTAL Growth
Governor’s Budget	0.79%	\$245.9	\$31.4	\$29.7	\$87.7	\$394.7

COMMENTS: The Department of Finance will update enrollment growth estimates as part of the Governor’s “May Revise” to reflect population updates.

OUTCOME: **No action.**

ISSUE 4: Major Adjustments – Cost-of-Living Adjustments (COLAs)

DESCRIPTION: The budget provides \$1.65 billion to fully fund statutory COLAs for K-12 revenue limit and categorical programs. This provides a 3.93 percent COLA for revenue limits and categorical programs.

BACKGROUND: K-12 education programs typically receive annual COLAs for all revenue limit programs and most categorical programs. Budgeted COLAs for the last five years are summarized below. During this period, there was only one year -- 2003-04 -- that the budget did not fund COLAs for revenue limits and categorical programs. The budget estimated COLA at 1.8 percent that year. In contrast, the 2002-03 budget provided a 2.0 percent COLA, which was higher than the estimated rate of 1.66 percent.

COLAs	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (Proposed)
Budgeted	3.17	3.87	2.0	0	2.41	3.93
Estimated	3.17	3.87	1.66	1.86	2.41	3.93

The Governor's budget estimates COLA at 3.93 percent in 2005-06, up somewhat from the 2.41 COLA budgeted in 2004-05. According to the Governor's estimates, COLAs for revenue limits total \$1.65 billion, including \$1.2 billion for revenue limits and \$428 million for categorical programs. The table below provides a breakdown of these costs, with additional detail for some categorical programs.

<i>Dollars in Millions</i>	Estimated COLA Rate	COLA \$: Revenue Limit	COLA \$: Special Education	COLA \$: Child Care	COLA \$: Other Categorical Programs	COLA \$: TOTAL
Governor's Budget	3.93%	\$1,222.1	\$156.6	\$50.8	\$220.4	\$1,650.0

COMMENTS: The Department of Finance will update COLA estimates as part of the Governor's "May Revise" to reflect inflation updates. According to the LAO estimates, the COLA will be 4.10 percent, slightly higher than the 3.93 percent estimated by the Governor, and will increase COLA costs by \$71.2 million for K-12 schools.

OUTCOME: **No action.**

ISSUE 5: Major Adjustments – Revenue Limit Deficit Factor

DESCRIPTION: The Governor's Budget proposes \$329 million to reduce the outstanding revenue limit deficit factor. Under this proposal, the state would reduce the deficit factor to 1.1 percent, or approximately \$317 million, in 2005-06. The deficit factor resulted from the elimination of revenue limit COLAs and revenue limit reductions in the 2003-04 budget.

BACKGROUND: The Legislature has approved deficit factors for revenue limits in years when the statutory COLA has not been fully provided, or more recently due to revenue limit reductions. Deficit factors reduce base revenue limits by a percentage tied to the level of the reduction or foregone COLA, compared to the other amount otherwise required by statute. During the early 1990's when the statutory COLA for revenue limits was not fully funded, deficit factors were as high as 11 percent. It took nearly 10 years for the state to eliminate these deficit factors and restore base revenue limits. (Buy-out was completed in the 2000-01 budget.)

As indicated below, the 2003-04 budget suspended the 1.8 percent COLA for revenue limit programs and reduced revenue limit funding by 1.2 percent, which resulted in approximately \$900 million in savings. Budget trailer bill language contained in AB 1754 (Chapter 227; Statutes of 2003) created a 3.0 percent deficit factor for these revenue limits reductions and foregone COLA's that would be restored to revenue limit calculations in subsequent years.

	2003-04	2004-05	2005-06
Deficit for Revenue Limit Reduction	1.2 %	.3%	0
Deficit for Foregone Revenue Limit COLA	1.8%	1.8%	1.1%
Total Outstanding Revenue Limit Deficit	3.0%	2.1%	1.1%

The 2004-05 budget provided \$270 million to reduce the deficit factor for revenue limits from 3.0 percent to 2.1 percent. The Governor's 2005-06 budget proposes an additional \$329 million for deficit factor reduction. This proposal would lower the deficit factor for revenue limits from 2.1 percent to 1.1 percent.

COMMENTS: The LAO recommends that the Legislature delete \$329 million for revenue limit deficit reduction and \$51 million for community college growth. The LAO believes that these proposed increases are not needed to maintain existing programs. Instead, the LAO recommends that the Legislature appropriate \$315 million of these savings to pay for ongoing K-14 mandates in 2005-06. (See following issue on Education Mandate Payments.)

[Budget Trailer Bill Language – See attachment]

OUTCOME: **No action.**

ISSUE 6: Education Mandate Payments

DESCRIPTION: The budget proposes to defer or suspend all funding for 41 ongoing education mandates in 2005-06. This is consistent with budget actions in recent years to achieve budget savings without reducing programs. According to the Legislative Analyst, mandated costs for K-12 schools are estimated at approximately \$300 million a year and cumulative, unpaid mandated costs claims are now estimated at \$1.4 billion. Under the Governor's proposal, the state would owe more than \$1.7 billion in unpaid, K-12 education mandate costs at the end of 2005-06.

BACKGROUND: After 2001-02, funding for education mandates costs basically stopped, and payments were deferred to future years or suspended. This action was taken to reduce expenditures given the fiscal circumstances that year and in subsequent years.

The Governor proposes to continue deferral or suspension of payments for education mandates in 2005-06. Technically, the budget appropriates \$1,000 for 36 separate mandates the Governor proposes to defer and zero funding for five mandates the Governor proposes to suspend in the budget year. The Governor's proposal is consistent with budget actions in recent years that have utilized mandate cost deferral – inside and outside of education – as a temporary budget solution.

By deferring reimbursement of mandate claims, the state is not eliminating its obligations. The state must eventually pay all claims, once audited and approved. The state must also pay interest on overdue claims, based upon the rate established for the Pooled Money Investment Account. According to the LAO, the state has paid \$48.6 million in interest on the unpaid mandates through 2002-03.

Mandate costs can be reduced through elimination or suspension of specific mandates. Chapter 895, Statutes of 2004 (Laird) eliminated eight K-12 mandates. The Governor proposes to continue suspension of five mandates in 2005-06, including: School Crimes Reporting II; School Bus Safety II; Law Enforcement Sexual Harassment Training; County Treasury Oversight Committee; and Investment Reports.

Chapter 216, Statutes of 2004 (SB 1108/Committee on Budget and Fiscal Review), the 2004-05 education budget trailer bill, appropriates \$58.4 million in one-time funds to pay for the oldest mandate claims no longer subject to audit. This statute also appropriates \$150 million a year beginning in 2006-07 for Proposition 98 settle-up repayment and specifies that any such funds must first be applied in satisfaction of mandate claims.

Chapter 216 directs the Commission on State Mandates to reconsider its decision on the STAR program mandate in light of federal statutes enacted and state court decisions rendered since several state statutes were enacted.

COMMENTS: As indicated in the previous item, the LAO recommends that the Legislature appropriate \$315 million to pay for ongoing K-14 mandates in 2005-06 instead of appropriating funds proposed by the Governor for revenue limit deficit factor reduction and community college growth. The LAO considers accumulated mandate cost deferrals to be the largest item on the state's education credit card. Under the Governor's proposal, the state will owe approximately \$1.7 billion for education

mandates by the end of 2005-06. For this reason, the LAO recommends that the Legislature give priority in the 2005-06 budget to funding ongoing mandate costs (\$315 million -- ongoing funds), and as additional funds are available, paying down existing unfunded mandates (\$1.4 billion -- one-time funds).

The LAO recommends that the Legislature recognize in the budget eight new education mandates that have been approved by the Commission on State Mandates in 2005-06. [The LAO was given responsibility for reviewing and commenting on newly identified mandates pursuant to Chapter 1124, Statutes of 2004 (AB 3000/Committee on Budget)]. The eight new mandates include: Comprehensive School Safety Plans; Immunization Records: Hepatitis B; Pupil Promotion and Retention; Standards Based Accountability; Charter Schools II; Criminal Background Check II; School District Reorganization; and Attendance Accounting. The Commission on State Mandates estimates costs for these mandates total \$76.9 million through 2004-05. Ongoing costs for these mandates are estimated to total \$11.3 million in 2005-06.

The Governor's budget recognizes one of these eight new mandates – Comprehensive School Safety Plans. The Department of Finance indicates that the Administration may update the list of included mandates at "May Revise" when additional information is available from the Commission on State Mandates.

OUTCOME: No action.

ISSUE 7: Program Payment Deferrals

DESCRIPTION: The Governor’s proposes to continue \$1.1 billion in various K-12 program payments that have been deferred from one year to the next in order to achieve budget savings without reducing services.

BACKGROUND: The Governor’s 2005-06 Budget proposes to continue \$1.1 billion in various revenue limits and categorical programs initially deferred from the 2002-03 fiscal year to the 2003-04 fiscal year. These deferrals were enacted in 2002-03 as a part of a package of mid-year budget reduction proposals to avoid program reductions. Specifically, the deferrals involve a shift in second principal apportionment payments, referred to as P-2 payments, from June to July 2003.

COMMENTS: The LAO considers deferrals as borrowing on the education “credit card” and recommends that if the Legislature chooses to provide a higher level of funding in the budget they begin paying off credit card expenses, including deferrals. The LAO further recommends that the Legislature make it a priority to repay deferrals before funding new expenditures or programs.

[Budget Trailer Bill Language – See attachment.]

OUTCOME: **No action.**